

~~CONFIDENTIAL~~Soviet Economic Performance: Trends and OutlookIssues and Goals

Gorbachev has made clear that the re-vitalization of the economy through S&T progress is his most important domestic priority. He realizes that without substantial improvement in its technological capabilities, Moscow will be unable to recapture higher growth rates and will be hard pressed to compete both economically and militarily with the West in the 1990s and beyond. To address these issues Gorbachev has instituted a series of initiatives. All are aimed at raising productivity and efficiency throughout the economy by matching more and better equipment with a motivated work force and an enlightened managerial cadre. He has put his finger on the very tasks that the economy has never performed well and that have become progressively harder to do as the economy has grown in size and complexity.

Implementation Plans

Gorbachev has outlined a multi-stage strategy. The economy will get an immediate boost through new personnel, renewed discipline, temperance and greater work effort. Additional gains are to come gradually from organizational changes--most notably measures to speed innovation by bringing R&D closer to the production line and the "bureaus" to streamline management in machinebuilding, energy and agriculture. Performance will also be aided by the industry-wide adoption in 1987 of the industrial management experiment begun in 1984 that gives more operational autonomy to end-user enterprises. These "human factor" adjustments are to contribute almost 1/3 of the productivity increase planned to support growth during 1986-1990. The other 2/3 of the planned increase in economic output is to be achieved by substituting new machinery for labor--especially in the relatively low technology areas that employ large numbers of manual laborers such as materials handling.

In the longer term Gorbachev is relying on his S&T Revolution to accelerate growth. To achieve this revolution Gorbachev has ordered a crash program to re-tool civilian machinebuilding--the sector tasked with producing the new and better equipment necessary to modernize industry. During the 12th five-year period, investment in this sector is to increase by 80 percent over its 1981-85 level.

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Soviet Plans for Joint Ventures

Moscow is actively pursuing discussions on joint ventures with many of its Western trading partners. The Soviet leadership has passed a decree that will permit up to 49-percent foreign equity and allow for some management and quality control, repatriation of profits, and other prerequisites to make such ventures attractive to Western firms. The Soviets probably see several advantages to such arrangements.

- o Partnership with a Western firm would provide access to established markets and trademarks that could make it easier to sell Soviet-made goods in the West.
- o Quality control by the Western partner would help assure that products meet world market standards.
- o A long-term equity relationship with a Western firm could allow for automatic updating of production lines to keep up with changing Western demands and technology.
- o Joint ventures would allow for transfer of technical know-how related to organization and management of production and the use of advanced technology that are not easily transferred through traditional equipment purchases.
- o Such arrangements would allow for the transfer of Western technology at little or no hard currency cost to the Soviets until after production begins. [REDACTED]

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The Soviets have expressed particular interest in establishing joint ventures in the manufacture of chemicals, machine-building, wood processing, electronics, communications, computer-aided designs, petroleum-refining and petrochemical industries, construction materials, and the light and food industries. Press reporting indicates that plans for establishing a chain of Pizza Huts in the USSR which is currently being negotiated call for a joint venture arrangement. Other US companies reportedly expressing an interest in joint ventures include Monsanto, General Electric, Abbott Laboratories, Occidental Petroleum,

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and Archer-Daniels-Midland, although we do not have details of the projects (see annex for a list of the areas under consideration for joint ventures that involve the United States and other Western nations).

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The Soviets have set general guidelines, but many of the specifics remain vague, and the Soviets could still be flexible in negotiating the details. Capital contributions from the West reportedly will take the form of equipment, technology, or financing, while spending for "social infrastructure" will be taken into account when calculating the Soviet share. Enterprise management will consist of a board with Soviets occupying the positions of both the chairman of the board and the director-general of the enterprise.

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According to Soviet press, production plans for joint ventures will not be centrally determined, and purchases from and sales to domestic enterprises are to be conducted through foreign trade organizations with prices set at world levels. Thus these enterprises will essentially be segregated from the rest of the domestic economy, even though they will be required to abide by Soviet law in setting wages, hours of work, and vacation time for Soviet workers.

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Progress in establishing joint ventures is apt to be slow. Some Western firms may be willing to make a relatively small investment to gain entry into the Soviet market but most are likely to take a wait-and-see attitude. Years of dealing with cumbersome Soviet bureaucracies, shoddy Soviet manufactures, and unimpressive results from joint ventures with other socialist countries will make most businessmen wary. Even Western enthusiasm for joint ventures in China--the socialist country with the most liberal regulations--has recently waned. In addition, Western firms are likely to encounter numerous difficulties before arriving at satisfactory contractual terms.

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specific problems cited by Western businessmen include an appropriate definition of profit and the accounting and pricing procedures to be used for raw material inputs.

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The Soviets themselves are also likely to approach actual negotiations cautiously. Granting the level of control over production decisions required by Western executives would go against the grain of most Soviet managers. At present, it appears that there is still a

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considerable amount of uncertainty among mid-level Soviet officials who deal regularly with Western businessmen over what joint ventures will entail. [REDACTED]

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Even if impediments to successful joint ventures can be overcome, the level of investment is likely to be too small to have much of an impact on expanding Soviet exports of manufactured goods. In addition, even if joint ventures prove to be efficient producers--especially if isolated from the uncertainties of the domestic economy--the Soviets are still likely to have difficulties in diffusing the technology beyond these enterprises. [REDACTED]

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While joint ventures with the West appear to be the current buzzword among Soviet officials, there are several other types of arrangements that the Soviets could pursue that would provide many of the same advantages. For example, buyback and coproduction arrangements would allow for access to Western markets, quality control, hard currency savings, and improved access to Western technology but with less direct Western involvement. Indeed, many of the the discussions under the rubric of "joint ventures" appear to be little more than coproduction or buyback arrangements in the manufacturing sectors. [REDACTED]

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Purchase of Western management services could also improve Soviet efficiency in introducing new technological processes and organizing production. Such arrangements should be particularly attractive to the Soviets in the key sectors of the economy where they might desire to limit the extent of Western involvement such as in agriculture and the development of raw materials. Discussions along these lines had begun late last year, but little has been said since the fall in oil prices and increased interest in joint ventures. [REDACTED]

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